

Briefing Note: Overage Payments in Land Transactions

Introduction

This Briefing Note should not be relied upon as legal advice and you should contact us for advice on your specific circumstances.

Briefing Note
January 2017

**For more information
please contact:**

Nicolas Wickens
Partner

01424 730945
nrw@gabyhardwicke.co.uk

A typical scenario is where a person is selling some land having a present value for which a price is being paid, but there is a chance that it may be worth more in the future, perhaps because planning permission may be granted. There are good reasons to sell now, but the person selling wishes to have a share in any increase in the value of the land if and when it happens. The legal mechanisms entitling the seller to a share in any potential increase in land value in the future are commonly called overage, or clawback provisions. In this note we shall just use the term overage.

This note picks out a few key issues for consideration in negotiating overage provisions and highlights some of the risks of not taking proper legal advice.

Different forms of overage provision

They can be in the form of a positive promise by a land buyer to pay to the seller, in addition to the basic price paid on completion of the land purchase, a potential additional sum triggered by a specified event (typically, the grant or implementation of planning permission for development on the land or the sale on by the buyer of the land to another at a profit).

There are two main alternatives to such a positive promise to pay. The first is a restrictive covenant by the buyer not to use the land for any different purpose than it is used for at the date of the buyer acquiring the property. For example, if the buyer acquires a house with a large area of land, the transfer of the land to the buyer could prohibit him from using the land otherwise than as a garden ancillary to the use of the dwelling house or perhaps as a paddock or for agricultural purposes. The idea is that if the buyer wanted to develop the land for an alternative higher-value use, he would have to come back to the seller requesting a relaxation of the restrictive covenant to enable him to do so, in return for which the seller would expect to receive a share of the development value. However, the use of restrictive covenants as a method of extracting potential overage payments is not generally recommended, in view of the difficulty of enforcing such covenants – at least in the absence of additional security.

Another method of securing potential overage is for the seller to retain ownership of a strip or strips of land (“ransom strips”) over which access to any future development on the land sold would be required. However, it is not always practicable for the seller to retain ransom strips around all the boundaries of the sale area and, if the seller does not do so, there will be a risk of the buyer being able to find some alternative means of access to the development site without having to cross the seller’s ransom strip. The location and dimensions of the ransom strip will also need to be carefully defined by reference to a land registry plan and capable of demarcation on the ground.

Ascertaining the date for payment

Care needs to be taken in defining the trigger(s) for overage payments. The seller might wish this to be the grant of planning permission for development or change of use. A buyer will prefer overage to become payable only once a planning permission is actually implemented (in other words, the development or change of use is started). This is because it will usually take the buyer some time from grant of planning permission to comply with any pre-conditions to start on site contained in the permission, to obtain any other consents necessary before starting the development and to obtain development funding.

If the seller wishes to extract overage upon a disposal by the buyer of the property at a profit, care will be needed in defining “disposal”. The seller might, for example, want to catch the grant of a long lease of land at a premium, rather than a freehold transfer – or even possibly the grant by the buyer of rights over the sale area to a third party to serve development on the third party’s land.

Briefing Note: Overage Payments in Land Transactions

The buyer might want certain disposals to be excluded from overage – for example, the purchase of individual house plots upon completion of the houses (provided that the buyer has paid overage to the seller upon the grant or implementation of planning permission for construction of the houses).

Method of calculating overage payment

Overage payments are typically a percentage of the uplift in value derived from the grant of planning permission for a particular development, or if triggered by a sale on of the property by the buyer at a profit, the difference between the price received by the buyer and the price originally paid to the seller. Whilst there is no hard and fast rule as to what that percentage is to be, if the seller reserves too high a percentage to himself, there may be little incentive to the buyer in seeking to develop the land, in which case the prospect of the seller receiving any overage at all would be diminished.

Care needs to be taken in calculating the overage payment by reference to the uplift in land value resulting from the grant of planning permission. It may be preferable to agree a fixed “base value” for the land upon its sale, by reference to which any uplift in value can be calculated. Alternatively, one could calculate the overage by reference to the difference between a defined “current use value” (being the open market value of the land at the date of the overage payment being triggered, on the assumption that the use of the land prior to its original sale was continuing).

It will be useful to include a mechanism for an independent valuer to determine the open market value of the land (whether its current use value or enhanced value with the benefit of planning permission).

Well drafted overage provisions will deal with attempts by the buyer/developer to depress the “open market value” on which overage is based (perhaps by temporarily encumbering the land with tenancies or third party rights over it which are subsequently released, or by selling on part of the land without adequate rights of way or to services and, subsequently, under a secret arrangement with the subsequent buyer, granting the latter the necessary rights).

Methods of securing overage payments

Sellers will usually want to make liability to pay overage enforceable not only against their immediate buyers but also against successors in title to the land sold. However, a positive obligation to pay a sum of money does not automatically run with the land and bind successors in title to the original buyer who promised to pay the overage. Methods of making overage payments binding on successors in title include:

- The seller taking a legal charge (mortgage) over the land. However this is not always practicable because the buyer will often need to mortgage the land to a bank in order to buy the land or develop it after obtaining planning permission, in which case the bank might refuse to grant the seller a second charge over the land to secure the overage payment.
- Instead of selling the freehold, the seller could grant the buyer a long lease of the land at nil rent. In that case, the buyer's positive obligation to pay the overage would be a tenant's covenant, enforceable against successive tenants under the lease. However a leasehold tenure is not as attractive a proposition as a freehold to a prospective buyer or their bank lender.
- The seller could reserve ransom strips around the perimeter of the land sold, giving the buyer an option to purchase the ransom strips on payment of the overage if and when it falls due.
- Restrictions can be placed in the register of the buyer's title to the land, prohibiting the buyer from selling it on without the seller's consent, which would only be granted upon payment of the required overage or the new buyer entering into a Deed of Covenant to comply with the Overage Agreement.

A buyer will not always be happy for overage payments to be binding on his successors in title. Having himself paid overage based on planning permission he has obtained for a specific development, the buyer might want the ability to sell on the land to a third party free from overage. However, the seller might wish the overage provisions to remain in force after his buyer has sold on the property with the benefit of such planning permission, in case the buyer's successor in title, instead of implementing the planning permission

Briefing Note: Overage Payments in Land Transactions

obtained by the buyer, subsequently obtains planning permission for a higher use value scheme or for development of a larger area of the land.

Capital Gains Tax

Sellers need to beware of their potential liability to pay CGT on the value in their hands at the date of the sale of the land of their potential right to receive overage at a later date. This can be problematic because the net proceeds from the sale of the land (after paying off any mortgage or paying for new accommodation) may be insufficient to pay the tax. Sellers will need, therefore, to take tax advice before entering into overage agreements.

Risks

The courts see disputes relating to overage provisions year on year, and there are always decisions which show parties losing out (i.e. not getting what they expected) because the overage agreement has not been drafted properly.

By way of example, in recent years there have been decisions where:

- A seller has lost more than 50% of what he expected to be paid by way of overage because the wording of the agreement lacked clarity. The case highlights the need for clear and comprehensive drafting of overage provisions.
- A seller has had to accept a decision from an expert surveyor as to the amount to be paid, even though it contains numerous errors. The court's view was that none of the errors were serious enough to justify interfering with the surveyor's decision.
- A seller tried to get around poor drafting by applying for its own planning permission (with a view to triggering the overage payment). The Court of Appeal dismissed the claim.

Knowing that this is an area which often leads to litigation, parties to overage agreements should be absolutely clear as to what they intend to happen and they should engage lawyers to translate this into clear, written agreements; consideration should be given to how disputes should be resolved cost-effectively; and worked examples should be used to 'test' the provisions to be sure that they work and are interpreted in the same way by both parties.

If you would like to know more about this topic or our legal services, please contact Nicolas Wickens: nrw@gabyhardwicke.co.uk or 01424 730945.

Gaby Hardwicke Solicitors
2 Eversley Road
Bexhill on Sea
East Sussex
TN40 1EY

Tel: 01424 730945
Fax: 01424 730096
www.gabyhardwicke.co.uk